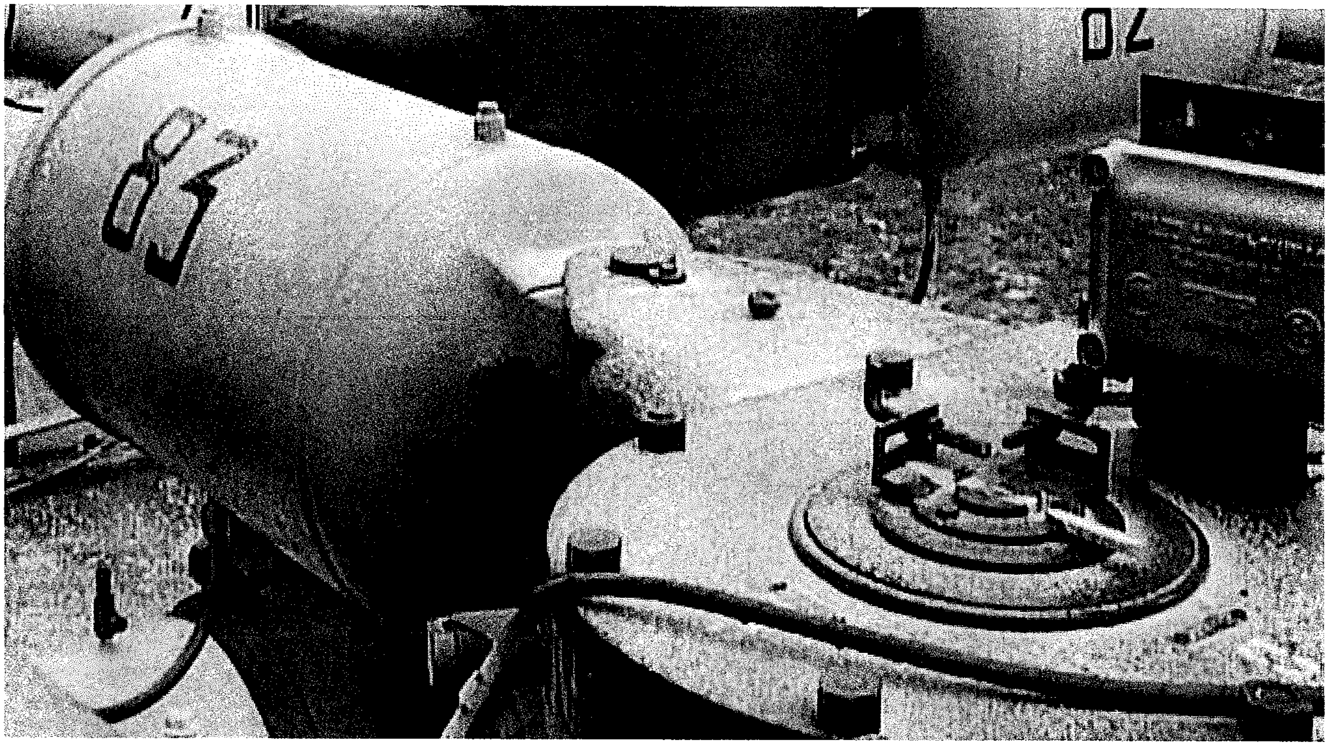


According to auditing directorate boss Mykola Syvulsky, speaking to *InvestGazeta*, every seventh employee was provided with a car at a total cost of 31 million hryvnas (US$6.2 million). Without naming individuals, Syvulsky concluded that managers 'had schemes installed allowing the enrichment of private persons and structures.'[202] No Naftohaz audit has been published on its website for 2004, Yuri Boiko's last full year as chairman. Global Witness spoke to Konstantin Borodin, who was Naftohaz's press secretary at the time of Boiko's chairmanship, concerning Syvulsky's claims and the downturn of the company's profits in 2003. Global Witness sent questions to Borodin at his request but has not received a reply.

However, Global Witness has seen a copy of an unpublished full management audit on Naftohaz in 2004, written in March 2005. The audit gives information which tends to confirm Syvulsky's claims and paints the picture of a creaking and inefficient state monolith with declining profitability. Though sales venues and gross profit again went up, the net profit went down, as the company took on more borrowings and incurred a large amount of fines. Apparently, at no time during the audit did the auditors receive any finalised documents from Naftohaz about the company's plans for natural gas deliveries and distribution in 2004.[203]

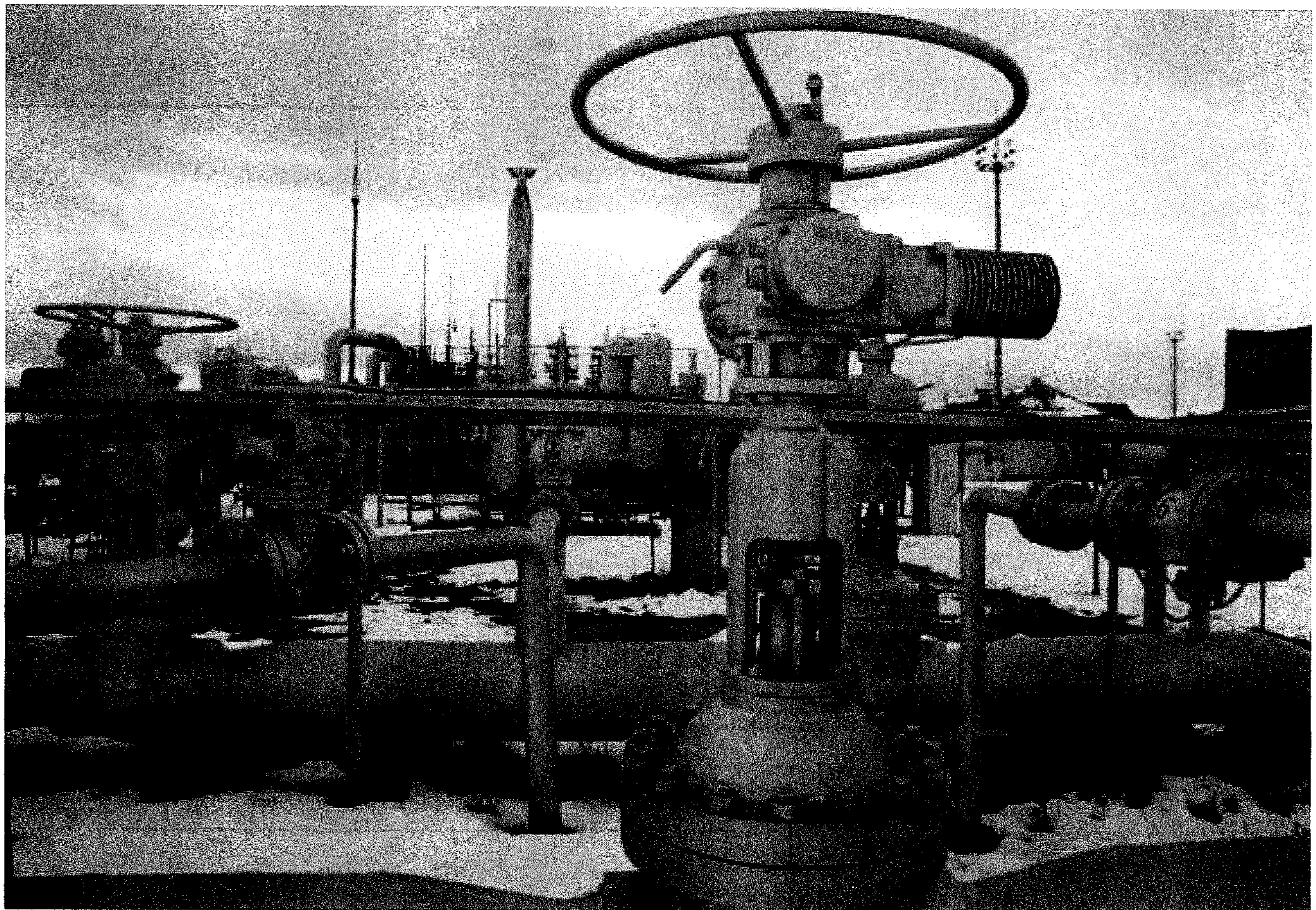
The main problems highlighted by the audit report run as a litany of bad management: (1) low-profit but high-cost operations, (2) use of intermediaries in its export operations, (3) high bonuses built into agreements between Naftohaz and its

powers, (5) ineffective management decisions, (6) the current dividend policy, (7) huge amounts of fines levied against the organisation (some 1.19 billion hryvnia (US$240 million) in 2004 or 20.8% of all its operational costs), (8) major unpaid debts, which prompted the audit's authors to call for an audit of the indebted companies themselves, (9) ineffective supervision by the Naftohaz supervisory board, (10) confused and ineffective management structures including a multiplicity of departments that duplicated each others work.[204]

In conclusion, the report notes: 'Certain management decisions, from the point of view of profitability, do not contribute to the effective use of the Company's assets and, as a result, they decrease the Company's profit and payments to the State budget.'[205] In January 2006, following the resolution of Ukraine's gas dispute with Russia, London-based credit ratings agency Fitch Ratings revised the outlook on Naftohaz's long-term local and foreign currency ratings from 'Stable' to 'Negative', meaning that it thought the company was now less able to pay off its debts.[206]

Much controversy around Naftohaz has centred in recent years on its failure to either dispense with or take control of the intermediary companies that have been contracted to transport Turkmen natural gas to Ukraine. Naftohaz's current management has stated in the past that it believes this area should not involve such companies, but should be organised solely by itself and Gazprom.[207] Yet schemes signed under former Naftohaz chairman Yuri Boiko, which involve such intermediaries, continue to this day. These mysterious

3. The gas transit and trading companies


AFP/Stringer

Introduction

Ukraine only produces about 25% of the gas that it needs, forcing it to import large amounts from Turkmenistan and Russia. Gas bought from Turkmenistan has to travel over 3,000 km to reach Ukraine. The pipeline that runs from Turkmenistan to Ukraine, the Central Asia-Centre pipeline, is controlled by Gazprom, the giant gas company which is 51% controlled by the Russian government.

Since the break-up of the Soviet Union, however, Gazprom has not been the sole direct controller of the transit of gas from Turkmenistan to Ukraine. Instead, this has been the domain of third-party intermediary companies which arrange transport of the gas with Gazprom to the Ukrainian border and resell it to the Ukrainian state oil and gas company Naftohaz Ukrainy. Gazprom itself often had difficulty getting payment for gas supplies from cash-strapped Ukraine, and the economic rationale for using these intermediary companies was that they could use their superior knowledge of the Ukrainian market to get paid, typically through barter. Another explanation offered to Global Wit-

was that the intermediary companies 'could enforce certain commercial conditions that Gazprom could not itself enforce for political reasons' – in other words, the intermediary companies, unlike Gazprom, were private entities which could press Ukraine to fulfil contractual terms without triggering a diplomatic spat with Russia. Intermediaries have thus acted as buffers in disputes between Russia and Ukraine, allowing both sides to claim they have benefited from the resolution of the dispute. This happened most recently in the winter of 2005/6 when Gazprom wanted gas prices higher than Ukraine was able to meet. The intermediary company RosUkrEnergo served as a solution, agreeing to buy the more expensive Russian gas and to supply Ukraine with cheaper Turkmen gas via Gazexport, Gazprom's export branch.

Yet the use of intermediary companies has been highly controversial in Russia and Ukraine. As this report will show, Gazprom has not only been accused of giving up lucrative business to the intermediaries which it could have kept for itself, but the companies themselves are highly opaque, both in their business dealings and their ownership struc-

sums of start-up capital into billion-dollar deals, with their true owners and beneficiaries hidden behind trusts, holding companies and 'scarecrow' directors – people not actively involved in the running of the company. Persistent questions about the true nature of the relationship between these companies and state officials in Russia and Ukraine, against a background of public concerns about official corruption and organised crime, remain unanswered. Given Europe's increasing need for Russian and Central Asian energy, lack of transparency casts a disturbing shadow over a gas trade that is growing increasingly important to European energy security.

The next part of this report examines four intermediary companies involved in the transportation of gas from Turkmenistan to Ukraine, the individuals behind them, and the deals they have struck.

1. Respublika

One of the first companies to transport gas from Turkmenistan to Ukraine was Respublika, headed by a Ukrainian businessman called Ihor Bakai, later the chairman of Naftohaz Ukrainy (see section: *Naftohaz under Ihor Bakai*). In February 1994, gas shipments to Ukraine from Turkmenistan were suspended because of Ukraine's non-payment of its accumulated gas debt. Desperate for gas supply to be resumed, the Ukrainian government sold its debts to Turkmenistan – around US$800 million – to Respublika, a private company.[208] According to the agreement, Respublika was to pay Turkmenistan US$275 million in hard currency and US$580 million in goods, including 10,000 tonnes of animal fat and 2,000 tonnes of baby food.[209]

However, Respublika failed in its task of clearing Ukraine's gas debt and Turkmenistan cut off gas supplies again in November 1994, prompting newly-installed Ukrainian president Leonid Kuchma to target Bakai's company a few months later and create a state commission to inspect its activities:

> At a news conference in Kiev, Wednesday [9 November 1994], [Kuchma] declined to make any preliminary conclusions, though he said he was amazed at the fact that 'a structure with a registered capital of 500 million karbovantsy [About US$3,000] obtained a multi-billion dollar contract'. Kuchma drew the journalists' attention to the fact that the concern, granted all possible privileges by the state, sold Ukrainian goods on the Turkmen market at prices much higher than their actual values. For example, the price of a Ukrainian-made TV set was above US$1,000. All this was told to Kuchma by Turkmen president, Saparmurat Niyazov,

> We bring warmth to people!
> *Itera motto*

Bakai himself is reported to have said in 1998 that 'all rich people in Ukraine made their money on Russian gas,'[211] though Respublika dealt primarily with Turkmen gas. Documents seen by Global Witness show that Ihor Bakai and his then-wife Elena bought a house in April 1994 for US$1.8 million in cash in Meadowbrook, Pennsylvania.[212] Bakai has stated that his father-in-law was the real buyer, and that he only contributed 10% of the total price,[213] even though it is Bakai's name on the deed. His father-in-law became the official owner of the property in December 1997. Documents also show that Elena Bakai purchased land worth US$475,000 in the same area of Pennsylvania in July 1995.[214] In an interview with a Ukrainian website, Bakai admitted that his mother-in-law had purchased land in Florida, but maintained that he had nothing to do with this purchase.[215]

Respublika's activities were never fully investigated. Some reports speak of a fire destroying its offices in 1995, preventing authorities from examining its tax records and financial dealings.[216] Out of Respublika's ashes Bakai formed Interhaz, which supplied Russian gas to Ukraine in 1996. In 1997, President Kuchma, the same man who had launched an inquiry into Bakai's Respublika three years earlier, agreed to the appointment of Bakai as the first deputy chairman of the state committee for the oil and gas industry. In 1998, this committee became part of the state company Naftohaz Ukrainy with Bakai officially appointed as chairman of the board.

2. Itera

Origins

Respublika had failed to clear Ukraine's gas debts to Russia and Turkmenistan, which were still having trouble getting payment for their gas. Another company, Itera, was to move onto the scene and control the supply of gas from Turkmenistan to Ukraine from 1994 to 2002. The founder of Itera, Igor Makarov, had previously had some success trading Turkmenistan's natural resources. Born in Turkmenistan, Makarov was a

moving into business, selling jeans in the Russian city of Kazan in the late 1980s.[217] In October 1992, he registered a company called Omrania Trading in Cyprus.[218] In 1993, Makarov supplied Turkmenistan with food products in exchange for Turkmen crude oil.[219] This was his first experience in dealing with natural resources.[220] Makarov himself told a Russian journal that he had entered the gas industry by accident when the Turkmen authorities offered to reimburse him in gas cargoes, worth US$30 million, that he then resold in Ukraine.[221]

In February 1994, Makarov registered a new company called Itera International Energy in Jacksonville, Florida.[222] By 2000, Itera, under its main holding company, Itera Group NV, had grown into the fourth largest gas company in the world based on its gas reserve base.[223] Makarov said in August 1999 that the group contained sixty companies with over 3,000 employees.[224] By 2001, Itera Holding, part of the Itera Group, had grown to 8,000 employees and 130 subsidiaries, with sales in 2000 of more than US$3 billion.[225]

Makarov has stated that the key to his initial success was the fact that: 'boyhood friends were moving into key government positions in Turkmenistan and "it was like a snowball."'[226] It is unclear exactly who these 'boyhood friends' were, but the links between Itera and the Turkmen government are very apparent.

Why would Russia's all-powerful Gazprom give up lucrative busi-

Turkmen president Niyazov's right-hand man at the end of the 1980s was Valery Otchertsov, the vice-president of the Turkmen parliament from 1989 to 1991.[227] After Turkmenistan gained its independence, Otchertsov became the minister of economics and was responsible in part for setting up TurkmenRosGas in August 1996, a company contracted to transport Turkmen gas to Ukraine. This company was a joint venture between the Turkmen government with a 51% stake, Gazprom with 45% and Itera with 4%.[228] Fourteen days after it was set up, Otchertsov was relieved of his duties in the Turkmen cabinet and made an advisor to the Turkmen ambassador in Moscow.[229] Otchertsov has stated to a Russian newspaper that his move to Moscow was due to 'family problems'.[230] According to Otchertsov, six months later he accepted an offer from Makarov to join him at Itera as vice-president.[231] Otchertsov has said that he absented himself from Itera's dealings with Turkmenistan as his previous position in the Turkmen government would have made it 'unethical'.[232] Global Witness wrote to Otchertsov with questions concerning his work in Turkmenistan and at Itera. Otchertsov is yet to reply.

Itera's business was founded on trade with Turkmenistan and Makarov himself said, as noted above, that the company's position was due in part to his 'boyhood friends' within the Turkmen government. Even when Itera branched out into other sectors, Makarov stated in 2003 that the group's main business had been transporting Turkmen gas to Ukraine.[233] Itera came to play an increasingly important role in this business after TurkmenRosGas was disbanded in June 1997. Niyazov blamed Itera for this business failure, asserting that the group owed Turkmenistan more than US$200 million.[234] Itera claimed, in turn, that it had been let down on barter deals with Ukrainian customers.[235]

Itera's 'know-how'

The joint venture between Turkmenistan, Gazprom and Itera appeared to end in acrimony, prompting President Niyazov to call for 'direct sales' from Turkmenistan to Ukraine. Yet if Niyazov was apparently ready to dispense with the services of Itera, Gazprom was not. The then-chairman of Gazprom, Rem Vyakhirev, stated that direct sales would be impossible as both Gazprom and Turkmenistan needed Itera.[236] He even described Itera as 'one of the best, if not the best company,' according to the *Washington Post*.[237]

Makarov told journalists in 2001 that Itera had 'set down mutually beneficial playing rules with Gazprom'.[238] He explained that Gazprom was not getting paid for gas sales to

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post-Soviet countries in the 1990s, but could not cut Ukraine out of the supply chain because its gas had to cross Ukrainian territory to reach more lucrative markets in Western Europe. Makarov said that Itera, on the other hand, had the 'know-how' to get payment out of Ukraine using a 'sophisticated and highly developed barter structure'.[239] Therefore, Gazprom, unwilling and unable to deal profitably with Ukraine, allowed Itera to try its luck in the hope that the latter would boost business in the wider region.

By 2002, however, Itera had gone beyond just arranging the sale of Turkmen gas in Ukraine. The group had moved into lucrative markets in other parts of the former Soviet Union which had previously been controlled by Gazprom. Even though Itera appeared to be taking business away from Gazprom, the Russian company seems to have given Itera a financial helping hand. In 1999/2000, Gazprom granted around US$880 million to Itera in loans, guarantees and other services, at a time when Gazprom was in a difficult financial position.[240]

One expert view is that Gazprom supported Itera at this time because it was vital for Gazprom to maintain supplies to Western Europe, which meant relying on Itera in Ukraine.[241] But some were deeply troubled. Hermitage Capital, a Moscow-based investment fund and a minority shareholder in Gazprom, produced a report in 2000 which alleged that, far from being 'mutually beneficial' (in the words of Itera's Makarov), the relationship between Gazprom and Itera was highly favourable to the latter and went beyond allowing Itera to sell gas through barter deals in Ukraine.[242]

Gazprom and Itera: too generous by half?

In December 1999, Gazprom's head Rem Vyakhirev was involved in negotiating a new gas contract with the Turkmen government. Global Witness has seen documents from Gazprom and the Russian accounts chamber which show that Itera bought gas from Turkmenistan, used Gazprom's own pipeline to transport it, then sold the gas back to Gazprom at a substantial mark-up.

In 2000, Itera bought a large volume of Turkmen gas at a price of US$35.37 per 1000 m^3, according to a report from the accounts chamber of the Russian Federation. The same document states that Gazprom bought about a third of this volume of gas from Itera at a price of US$45 per 1000 m^3. Gazprom's own consolidated financial statements, recorded an even higher price in roubles, equivalent to about US$50 per 1000 m^3.[243] In other words, Gazprom paid Itera much more than if it had bought the gas at source in Turkmenistan.

According to a press report, Gazprom's management explained that the difference in price was due to 'Itera's transportation costs'.[244] The inconsistency apparent in this explanation is that the document from Russia's accounts chamber states that transportation costs were reimbursed by Gazprom in a separate agreement.[245] Although the exact cash value of such deals is hard to calculate because of the barter element, the figures in the contract suggest that Itera may have made more than US$100 million by selling gas to Gazprom that the Russian company could have bought directly from Turkmenistan.

One analyst who spoke to Global Witness about this deal suggested that Gazprom might not have been able to buy directly from Turkmenistan; Itera's strong links with that country meant that the group 'knew how to deal with the Turkmenbashi [President Niyazov].' But the analyst noted that this does not explain why Gazprom allowed Itera to sell its own gas in Gazprom's traditional markets around the former Soviet Union: 'How did Itera get Gazprom to agree to third party access for its gas from the place it wanted, to the place it wanted, when nobody else could? That's the mystery.' The scale of Itera's expansion into these markets was huge: Hermitage Capital estimated that from 1996 to 2002, Gazprom surrendered over 50% of its gas markets in the former Soviet states to Itera.[246]

Concerning his company's relationship to Gazprom, Itera's Igor Makarov stated in an interview with a Russian newspaper: 'I want to clarify once again that Gazprom does not give us any special deals or offer us any preferential conditions.'[247] Yet Gazprom minority shareholders wanted further clarifications and called in 2000 for the relationship between Itera and Gazprom to be investigated in the form of an independent audit. A proposal for an audit by Deloitte and Touche was rejected by Gazprom chairman Rem Vyakhirev, who instead appointed Gazprom's own accountancy firm PricewaterhouseCoopers (PwC) in January 2001.[248]

The audit was completed in June 2001 and found no improper links between the two companies. The report was heavily criticised by William Browder of Hermitage Capital Management, who sued PwC for what he regarded as a misrepresentation of the facts. The case was dismissed by Russian courts, on the basis that his fund had no direct business relationship with Gazprom's auditors and therefore could not sue PwC.[249] Another minority shareholder, Boris Federov, a former Russian finance minister, spoke out against what he saw as PwC ignoring information in order to retain its relationship with Gazprom.[250]

A Russian accounts chamber report completed in July 2001 also did not conclude that improper links existed between Itera and Gazprom, and stated that neither company had acted illegally. Yet the report did express surprise that credits had been granted despite the fact that Gazprom and Itera were nominal competitors and noted that Gazprom had granted credits to Itera while itself being in a difficult financial situation. The audit manager, Mikhail Beskhmelnitsyn stated: 'I will not confirm that all the credits and guarantees extended by Gazprom to Itera were justified. I am not in position to answer this question.'[251] Global Witness wrote to Igor Makarov with questions concerning his company's relationship with Gazprom. He is yet to reply.

Itera's ownership 'revealed'

Itera itself decided to release some information concerning its shareholder structure at the time of the ongoing audits in April 2001. It was revealed that Igor Makarov owned 26% of the main holding company Itera Group NV (registered in the Dutch Antilles) through organisations serving as trustees. Other named individuals owned 13%, with the remaining 61% of shares held in two trusts for unnamed top managers and employees. Dutch Antilles law states that even the government is not entitled to know who the ultimate beneficiaries under a trust-type arrangement are.[252]

Though PwC investigated Itera's shareholding structure, 19 Gazprom employees, including three members of the management body, refused to confirm or deny whether they or their families owned shares in Itera. Former Gazprom chairman Viktor Chernomyrdin did not reply, and Aleksandr Pushkin, the man in charge of the gas markets in former Soviet countries and perhaps the person best equipped to explain Gazprom's business relationship with Itera, was taken ill and could not meet with PwC staff.[253]

Mikhail Beskhmelnitsyn of the Russian audit chamber's office declared meanwhile that he knew 'for sure' that there were no Gazprom managers, their relatives or their namesakes within Itera's structure.[254] However, as noted earlier, Itera shares were held in trust-type arrangements which did not reveal their ultimate owners.

Information concerning Itera's many affiliates was not disclosed; Itera said this would have been too 'labour-intensive'.[255] Itera's ownership structure changed following the audits. In March 2003, Makarov stated he had increased his share to 46%. Two months later, former Turkmen deputy prime minister Valery Otchertsov stated that he owned 7% of Itera.[256]

Itera loses its contract

The appointment of Vladimir Putin as president of the Russian Federation brought major reforms at Gazprom. Putin was keen to improve the management of the company, stating in 2001, 'we know that enormous amounts of money were misspent [by Gazprom],'[257] though he did not refer to any particular case.

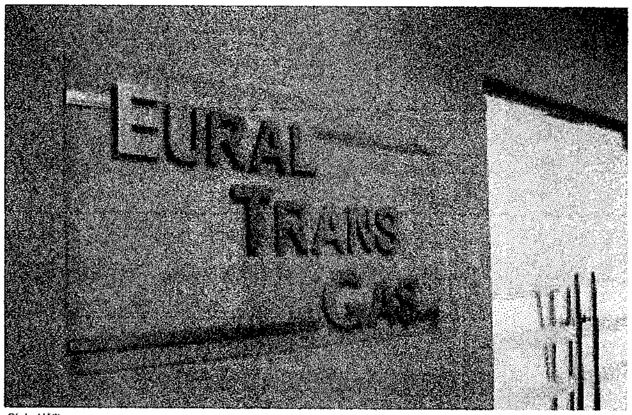
By this time, Viktor Chernomyrdin had already left Gazprom, stepping down as the chairman of its board in June 2000. At the time of the Gazprom-Itera audits in 2001, Rem Vyakhirev and his close associates Vyacheslav Sheremet and Aleksandr Pushkin left Gazprom. At this point, according to a list of wealthy Russians in *Forbes* magazine, all of them had sizeable fortunes.[258] According to Itera chairman Igor Makarov, speaking to *Russky fokus*, Vyakhirev, Sheremet and Pushkin cooperated with Itera following their departure from Gazprom, with Sheremet acting as a consultant to Makarov. 'We have signed contracts with many experts who left Gazprom,' said Makarov.[259]

The new Gazprom team under its new chairman Alexei Miller restructured the company's management and started to take back assets and markets it had previously ceded to Itera. More money started to flow into Gazprom and it seemed too that the company's new management would take over the Turkmen gas transit business.

In November 2002, Gazprom reduced the amount of gas Itera was allowed to supply to Ukraine. At the end of November, Gazprom deputy chairman Aleksandr Ryazanov stated that 'the transit contract of Central Asian gas to Ukraine may be fulfilled by Gazprom itself. We will supply Turkmen gas to Ukraine on the same terms as Itera, and maybe even better ... Why should Itera make super-profits using the facilities of Gazprom?'[260] His words, questioning Itera's involvement in Gazprom's business, seemed to echo minority shareholders' concerns that Gazprom was foregoing profits from a business that it could be controlling. Gazprom then terminated Itera's transit contract altogether.

One commentator told Global Witness that Putin was wary of the power Itera had gained in Russia and looked to reduce it.[261] Later, comments made by current Naftohaz chairman Oleksei Ivchenko suggested that Ukraine too was looking to remove Itera as the intermediary, because it had been taking business away from Naftohaz by selling gas to customers within Ukraine.[262]

Yet the events of 2003/4 quickly dispelled any hope engendered by Ryazanov's words that the Turkmen-Ukraine gas

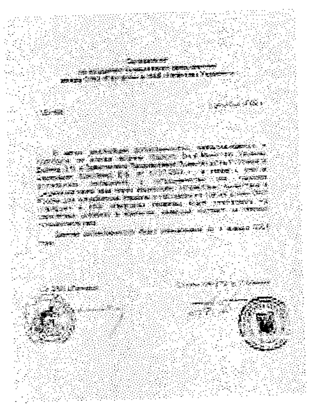


Global Witness

3. Eural Trans Gas

Origins

Following Itera's loss of the contract, both Naftohaz Ukrainy and Gazprom intended to participate in a joint venture company for the transit of Turkmen gas, starting 1st January 2003. This is confirmed by a document seen by Global Witness (below), signed 5th December 2002, between both parties 'on the creation of a joint venture between OAO Gazprom and NAK Naftohaz Ukrainy' to transport Central Asian gas to Ukraine: Gazprom and Naftohaz 'will participate on a basis of parity in a company which possesses the contract for the transit of Turkmen gas.'[264] Though Gazprom controlled the pipeline from Turkmenistan to Ukraine, Naftohaz's participation in this joint venture was probably intended to mitigate any concerns Gazprom had about Ukraine not paying for its gas and reflected the mutual dependency between the two countries: Naftohaz needed Gazprom to supply gas to Ukraine, Gazprom needed Naftohaz to get gas through Ukraine's territory to customers in Europe.



The joint venture vehicle was not given a name in the document, yet on the same day as it was signed (5th December 2002), Gazprom signed a contract with Eural Trans Gas (ETG), a new company, registered the previous day in Budapest, concerning Turkmen gas supply to Ukraine.[265] The idea, therefore, seemed to be that this company was the joint venture vehicle to be controlled by both Naftohaz and Gazprom. Yet ultimately neither company managed to take hold of the structure, leading to many questions about who actually was controlling it.

> Eural Trans Gas is about transit and transparency
> *Eural Trans Gas Press Release*[263]

Much remains unclear concerning ETG to this day. How did a company originally conceived as a joint venture between the state gas companies of Russia and Ukraine end up being controlled, as this section will demonstrate, by a complex network of offshore companies, whose beneficiaries are unknown? What role did ETG perform in the gas trade to justify large profits that would otherwise have gone to the Russian or Ukrainian states – and why did both Gazprom and Naftohaz later downplay their involvement with it? These questions remain unanswered.

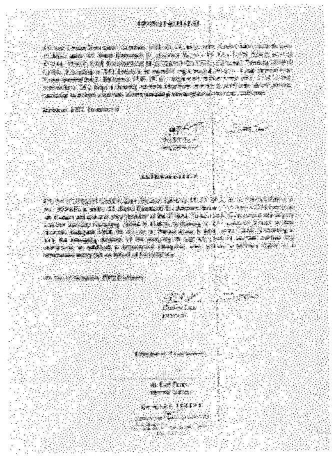
Who is Eural Trans Gas?

Forging a close relationship with Gazprom, Itera had grown into an international gas trader with its own gas reserves, transportation equipment, storage facilities and over 8,000 employees. This was not true of ETG, which was created just a month before it started operations and had a workforce of about 30 people.[266]

Gazprom made no public announcement that a new intermediary company was taking over the gas transportation from Turkmenistan to Ukraine. It was not until the end of February 2003 that Gazprom spoke for the first time to *Vedomosti*, a Russian business paper, about the existence of ETG, although the company had been operating since January of that year, following its December contract.[267]

The ETG website states that its Managing Director, Andras Knopp, 'founded' the company,[268] and it was he who signed the contracts with Naftohaz and Gazprom on behalf of ETG.[269] After serving as a state secretary for culture in communist Hungary,[270] Knopp had become a businessman, selling cigarettes through a German-based company named Reemtsva,[271] which possessed factories in Russia and Ukraine. The short curriculum vitae given on ETG's website concerning Knopp does not mention any previous links he had to the gas industry.[272]

According to foundation documents seen by Global Witness, ETG was registered by an Israeli lawyer named Zeev Gordon with start-up capital of 3 million Hungarian forints, some US$12,000.[273] In phone interviews with Global Witness, Zeev Gordon stated that he had been asked to register the company by a Ukrainian businessman called Dmytro



first interview conducted in August 2005 Gordon said that he was Firtash's lawyer, though in a second conversation in February 2006, Gordon stated that he was simply asked by Firtash to register the company and was not representing him at the time of ETG's registration.[274]

Gordon told Global Witness in the second interview that his involvement with ETG had been minimal; he went to Hungary in December 2002, signed the paperwork and flew home the next day: 'I understood that pretty soon the shares would be transferred from me to someone else.' Later in December 2002, according to Hungarian registry documents seen by Global Witness, some of Gordon's shares were transferred to three Romanian citizens. This was done, according to Gordon, by Andras Knopp, on whom he had conferred power of attorney.[275]

A journalist in Romania located the three new shareholders and discovered that they had no involvement in the gas industry. One of them, an actress named Louise Lukacs, told the journalist that she had contacted the two other shareholders, a couple, Anca Negreanu and Mihai Savu, after a Hungarian friend, a lawyer, had contacted her. The couple were told that if they visited Hungary to register as the shareholders of ETG they would be given some money. Lukacs said that she herself had agreed to the scheme because she needed some extra money to pay her phone bill.[276]

Actress Louise Lukacs lent her name to Eural Trans Gas in return

A source familiar with the company told Global Witness that the transfer of some shares to the three Romanians was necessary because a Hungarian offshore company had to have more than one non-Hungarian citizen as its registered owners.[277] Thus it appears that the three Romanians were brought into ETG at short notice, purely to fulfil a requirement for foreign shareholders. It is safe to assume, since the Romanians were being paid for this service, that they were shareholders in name only, and that the beneficial ownership of the company was held somewhere else.

Why was ETG founded in Hungary? According to then-company spokesman Boris Shestakov, speaking to the *Kyiv Post*, ETG benefited from Hungarian tax privileges for all newly registered companies which were valid until the end of 2005.[278] This was confirmed by Andras Knopp, who explained to a Hungarian newspaper that ETG was founded in Hungary to take advantage of a better tax environment; [279] tax for companies registered by foreigners in Hungary was 3% in 2003 – compared to 24% in Russia and 30% in Ukraine.[280] If this is accurate then Russia gave up tax revenues of an estimated US$184 million[281] by allowing a non-Russian company, rather than Russia's Gazprom, to control the gas transit from Turkmenistan across its territory.

Gazprom or Naftohaz: who's the daddy?

As mentioned above, Naftohaz Ukrainy and Gazprom had signed a document to create a joint venture to supply Turkmen gas to Ukraine, and in an interview with the *Kyiv Post*, Andras Knopp indicated that ETG was to be this venture: 'ETG does not act independently from them [Gazprom and Naftohaz]. They created ETG … Obviously the four [original owners, the three Romanians and Zeev Gordon] are nominal – the restructuring process of ETG's ownership is ongoing and both Gazprom and Naftogaz Ukrainy will have some share in ETG.'[282]

As time progressed, both Naftohaz and Gazprom started to distance themselves from ETG as controversy started to mount. In May 2003, the US ambassador to Ukraine told a conference in Kyiv of his concern over media reports that linked the company to organised crime.[283] These links were

Through 2003 and 2004 Naftohaz and Gazprom made comments that were inconsistent with each other concerning ETG's creation. Naftohaz emphasised that Gazprom was the driving force behind ETG; in late 2003, the company's then-spokesman Konstantin Borodin told the *Moscow Times*: 'All the agreements with Eural Trans Gas were made by Gazprom. It is a contractor for Gazprom.'[285] And a further Naftohaz source told the *Moscow Times* that it did not care who received the gas transit concession.[286]

But Gazprom's Aleksandr Ryazanov, who had earlier questioned the role of Itera as an intermediary in the Turkmen-Ukrainian gas trade, stated to *Vedomosti* in 2003 that the creation of this new company was 'a compromise between Gazprom and Naftohaz Ukrainy.'[287] Later in June 2004, Ryazanov stated that it was Ukraine who had made the decision to use ETG,[288] a view corroborated by other Gazprom managers, who had earlier reportedly complained that they had been forced into the arrangement with ETG by Ukraine: 'In September 2003, the situation with ETG was discussed by the Gazprom board of directors ... The management agreed that the current situation damaged the reputation of the company; however they said that they "were not within their powers to do anything"'.[289]

Despite this fact, Gazprombank and another major Russian bank provided ETG with loans exceeding US$227 million in 2003, according to ETG's website.[290] This was highlighted by Gazprom minority shareholders, including Hermitage Capital, which again noted that Gazprom was never a shareholder in the company, but was giving up business to this third party;[291] ETG went on to sell gas in markets that Gazprom should have been controlling (see section: *How much money?)*. Russian energy expert Jonathan Stern suggested to Global Witness that this money would have been used for ETG's storage in Ukraine, and as such, it was in Gazprom's interest to provide loans in order to promote gas supply within Ukraine.[292]

The Russian side continued to distance itself from ETG. Statements in June 2004 to *Vedomosti* by Gazexport director Aleksandr Medvedev suggested that Naftohaz was not calling the shots as regards ETG, but higher powers in Ukraine: 'ETG is the nominated agent for the transit of Turkmen gas to Ukraine, it was nominated not by Naftohaz Ukrainy but by the Ukrainian government; the reasons why the Ukrainian government selected ETG are beyond our competence as is the system of mutual payments between

The 'joint venture' goes awry

In an interview with Kyiv-based weekly *Zerkalo nedeli*, Knopp reiterated that ETG's 'real "parents"' were Gazprom and Naftohaz Ukrainy: 'The complicated process is underway of finding an ownership structure that will reflect the real situation and will meet legal requirements.'[294]

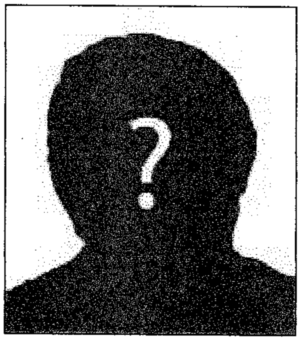
Confirmation that Naftohaz and Gazprom intended to take control of ETG came in early 2003 from Naftohaz's chairman Yuri Boiko. *Zerkalo nedeli* reported that he had said: 'The decision was taken concerning the direction of the purchase of the first shares of ETG and we are now conducting talks with the Russian side so that they too can do that. ETG itself is an instrument. Tomorrow it could be NAK [Naftohaz], Gazprom or another legal entity.'[295]

Despite Naftohaz and Gazprom's intention to create a joint venture for the supply of Turkmen gas to Ukraine, neither company ever became direct shareholders in ETG. Andras Knopp himself stated that, at the time of ETG's creation, neither Naftohaz nor Gazprom had received permission from their respective central banks to purchase shares in ETG. He also said there were other legal complications, including the requirement that registered owners of a Hungarian offshore company do not possess other businesses in Hungary, of which Gazprom already had several.[296] One industry analyst suggested to Global Witness that Gazprom might not have realised this obstacle because ETG had to be created quickly, before the start 2003, in order to qualify for better tax concessions.[297]

Despite these initial problems, it appears that Naftohaz and Gazprom continued to talk about becoming shareholders in ETG, but these plans were shelved in summer 2003. Naftohaz's then-spokesman, Konstantin Borodin, told the *Kyiv Post* in July 2003 that talks had broken down because of Gazprom: 'It is no longer planned that Nafto[h]az Ukrainy will become a shareholder in [Eural Trans Gas]... There were talks with Gazprom to jointly become shareholders, but Gazprom did not support this, and we can not become a shareholder without Gazprom's support.'[298]

Yet a source from Gazprom told *Vedomosti* that: 'We wanted to have a minimum 50% in Eural Trans Gas. But the Ukrainian side suggested a different variant: 40% each to Gazprom and Naftohaz and the remaining 20% to some incomprehensible structures, possibly to ETG manage-

The mysterious Mr D.V. Firtash



As noted earlier, Eural Trans Gas was originally registered by Zeev Gordon, an Israeli lawyer. Gordon initially told the press that he could not reveal on whose behalf he had done so, but he later told Global Witness that he was acting for Dmytro Vasylevich Firtash, a Ukrainian businessman.[300] The role of Firtash is one of the central mysteries of the ETG story. The company was registered on the very same day that Naftohaz and Gazprom agreed to create a new joint venture, but according to Gordon, Firtash was acting as a private businessman and not on behalf of either the Ukrainian government or Gazprom. So why was it Firtash who had ETG created, rather than someone acting for one of the two state companies? What was his relationship to Naftohaz and Gazprom, and was he acting on anyone's behalf other than his own? Global Witness has been unable to contact Firtash to ask him these questions.

Although Firtash had ETG registered, his exact relationship to the company is unknown. His name does not appear on any of the shareholding documents seen by Global Witness that pertain to ETG; when Global Witness asked Gordon whether the fact that Firtash asked him to register the company meant that Firtash owned shares in it, Gordon replied: 'You know you could assume such a thing but … I don't think there was a document which said "I am holding the shares and the holder is Mr Firtash."'[301]

Nor is Firtash listed as a director of ETG or a shareholder in any of the companies that took over its ownership in April 2004 (see below). The relationship between Firtash and Andras Knopp, the managing director of ETG, has also yet to be clarified. Global Witness asked Gordon whether it was his understanding that Knopp was working with Firtash. He replied, 'That is what I understood, but I don't know exactly what was the situation.'[302] Global Witness wrote to the company and to Knopp, asking them to clarify the role of Firtash: ETG's lawyers, responding on behalf of the company and Knopp, refused to answer specific questions.[303]

Little is known about Firtash's involvement in the gas industry. Official company records from Cyprus show Firtash to be the director of Highrock Holdings, registered in Nicosia. It is believed that this company was involved in supplying Turkmenistan with barter goods, dating back to when Itera held the gas transit contract. Gordon said 'I think he [Dmytro Firtash] was, if I'm not mistaken, involved [in business] with Itera.'[304] Global Witness wrote to Itera concerning its past relations with Firtash; it has yet to reply.

Highrock Holdings has no website, and phone numbers obtained by Global Witness of Highrock's office in Moscow did not work. One source familiar with the Ukrainian gas industry told Global Witness that the company might have folded.[305]

There is scattered information about Firtash's other business dealings. He is the board chairman of Nitrofert, the only fertiliser factory in Estonia, whose website states that the plant alone uses 'as high as 25% of total amount of natural gas sold within Estonia annually.'[306] It has also been reported that he is the owner of a Ukrainian basketball club, BC Kyiv[307] and Ukrainian cable television channel K1.[308]

Global Witness rang the Nitrofert plant and was told by a secretary that she was not allowed to provide any contact information for Firtash. Global Witness also asked Zeev Gordon how to contact Firtash in order to shed some light on ETG: the lawyer replied that he thought Firtash was not answering any questions at the time.[309]

Rural England: an unusual connection to Ukraine's state oil and gas company

Information from Ukraine suggests that Highrock Holdings, a company directed by Firtash, was involved in a joint venture with Naftohaz Ukrainy at the time when part of the Turkmen contract was still being paid in barter. A document from Ukraine's state tax administration gives details of a limited company registered in late 2002 called the ZAO Clearing Goods Company Naftohaz Ukrainy. According to the document, the company had a base capital of 210,000 hryvnia (US$40,000), 51% of which was provided by Naftohaz Ukrainy and 49% by a UK-registered company called Highrock Textiles Limited.[310]

An Interfax-Ukraine press article, which was citing the government commission on Ukraine's stock market and securities, stated that barter payments with Turkmenistan were arranged through NAK Clearing Goods Company Naftohaz Ukrainy, until the company was liquidated in December 2004.[311] A source familiar with the company said it was liquidated a little later in around June 2005.[312]

The relationship between Naftohaz Ukrainy and Firtash remains unclear; Global Witness wrote to Konstantin Borodin,

Goods Company was operating, about the company's relationship with Firtash. Borodin has yet to reply.

According to UK Companies House records, Highrock Textiles Ltd was registered in June 2002. Both its shareholder and director are given as Highrock Holdings. Another director of this company until June 2003 is given as Marios Tzortzis. Global Witness discovered that Tzortzis works for a Cypriot-based firm called One World Services which took over from Tzortzis as Highrock Textiles' director in June 2003.[313] One World Services has an office at the same registered address of Highrock Holdings in Nicosia, Cyprus. Global Witness rang Tzortzis to ask him about Highrock Textiles. He said: 'I would prefer not to answer questions ... I'm not aware about this. I'm just a nominee director.' He also said he didn't know anything about Highrock Holdings, or its director Dmytro Firtash.

Highrock Textiles and another company owned by Highrock Holdings named Highrock Oil are registered in the quaint market town of Tiverton in Devon, deep in the English countryside: the address given for both is 22, The Avenue. It is unclear why the state oil company of Ukraine formed a joint venture with a company based in an English town of 20,000 people that is better known for its provincial market and its lace than for links to barter trade in the former Soviet Union.

Global Witness went to Tiverton and discovered that 22, The Avenue is currently a shelter for homeless people and had previously been an old people's home. Other registry records for both Highrock Textiles and Highrock Oil demonstrate that both companies were administered by McKenny's, an accounting firm in Tiverton: a representative from this firm told Global Witness that he was not prepared to answer questions on specific clients, but added that he had never heard of Dmytro Firtash. Concerning his

22 The Avenue, Tiverton, Devon: hub of the Ukrainian oil industry?

firm, he said: 'We provide a registered office to various different companies ... We deal with professional intermediaries ... professional accountancy firms, firms of lawyers who want companies established for them. We do our own due diligence but it doesn't involve necessarily the activities of the company.'[314] The registered address of both Highrock Textiles and Highrock Oil has since moved from Tiverton to an address in London.

New owners for Eural Trans Gas?

In April 2004, 15 months after the creation of Eural Trans Gas, its shares changed hands. But once again, neither Naftohaz Ukrainy nor Gazprom became a shareholder in what had apparently been intended as a joint venture between the two companies. The complicated new ownership structure actually raised even more questions about the identity of ETG's ultimate beneficiaries.

According to Zeev Gordon, who returned to Budapest for the occasion, the shares in ETG changed hands on a single day.[315] The new owners were a British company called Atlantic Caspian Resources, which became the owner of 44.67% of ETG shares, a Dutch company called JKX Gas BV, owning 30%, and an Austrian firm, DEG Handels, which became the owner of the remaining 25.33% of the shares.[316]

This change of ownership made it appear that ETG had been taken over by savvy energy companies looking to invest in a booming market. But investigations by Global Witness show that two of the new shareholders were ultimately controlled by the same two holding companies in Cyprus – Dema Trustees Limited and Dema Nominees Limited, and that the third shareholder was also indirectly linked to the Dema companies. The ultimate beneficiaries of Dema Trustees and Dema Nominees are unknown. This complicated structure obscures the beneficial ownership of ETG behind several layers of what appear to be mostly shell companies, often directed by proxies, and created or bought shortly before the takeover was effected.

Throughout the web of offshore companies owning ETG, some of the same names reappear: a group of British businessmen who share an office in London and a firm of Cypriot accountants based in Nicosia. Although ETG was

[Eural Trans Gas] has also started to introduce Western-style transparency into the region
Eural Trans Gas Press Release

apparently created at the behest of a Ukrainian, Dmytro Firtash, and made huge profits from its role in the transportation of Turkmen gas through Russia to Ukraine (see section: *How much money?*), not one of the people named in the new ownership structure was Russian, Turkmen or Ukrainian.

The shareholders in depth

A. Atlantic Caspian Resources

In April 2004, ETG appointed Cedric Brown as its non-executive chairman.[318] Brown, a former head of the privatised UK gas monopoly, British Gas, had became a controversial figure in Britain in the mid-1990s for accepting what was seen as an excessive pay rise. At the time of his appointment at ETG, he stated that the company aimed 'to achieve the highest standards of transparency.'[319]

Cedric Brown was also the chairman of one of ETG's three new owners, a small British oil company named Atlantic Caspian Resources. In November 2003, Atlantic Caspian had been facing bankruptcy with only £300 left in the bank. In December 2003, it was rescued by a Cyprus-based company called Denby Holdings, which bought out Atlantic Caspian's debt in return for its shares.[320] In this same month, another Cyprus-registered company was set up, called Sanilia Ventures Ltd.

At some time before February 2004, Sanilia Ventures became the 44.67% owner of ETG via another holding company, though exactly how this happened is unclear.[321] Denby Holdings and Sanilia Ventures then both became owners of Atlantic Caspian in March 2004 while the latter became the owner of 44.67% of ETG.[322] Denby Holdings and Sanilia Ventures are jointly owned by the same two companies, Dema Nominees and Dema Trustees.[323] This is the first of the indirect links from ETG to the two Dema companies in Cyprus.

Denby Holdings operates out of an office in central London that is also the address of a company called Belgravia Business Services.[324] Three British men who work from this office have been associated in various ways with companies that own ETG – Robert Shetler-Jones (see box: *An Englishman in Ukraine*), David A.H. Brown and Howard G. Wilson. Company documents seen by Global Witness show that Shetler-Jones and David Brown (who is not related to Cedric Brown), are directors of Denby Holdings.[325] David Brown is also a director of Atlantic Caspian Resources.[326] In a striking development, the same three men would go on to have an association with the company that eventually took

> Our aim is to achieve the highest standards of transparency
>
> *Cedric Brown, speaking as non-executive chairman of Eural Trans Gas*[317]

over the lucrative gas middleman slot from ETG, the similarly controversial RosUkrEnergo (see section: *Links between RosUkrEnergo and Eural Trans Gas*).

B. JKX Gas BV

Another new shareholder in Eural Trans Gas was a Dutch company called JKX Gas BV, whose history also gives rise to unanswered questions.

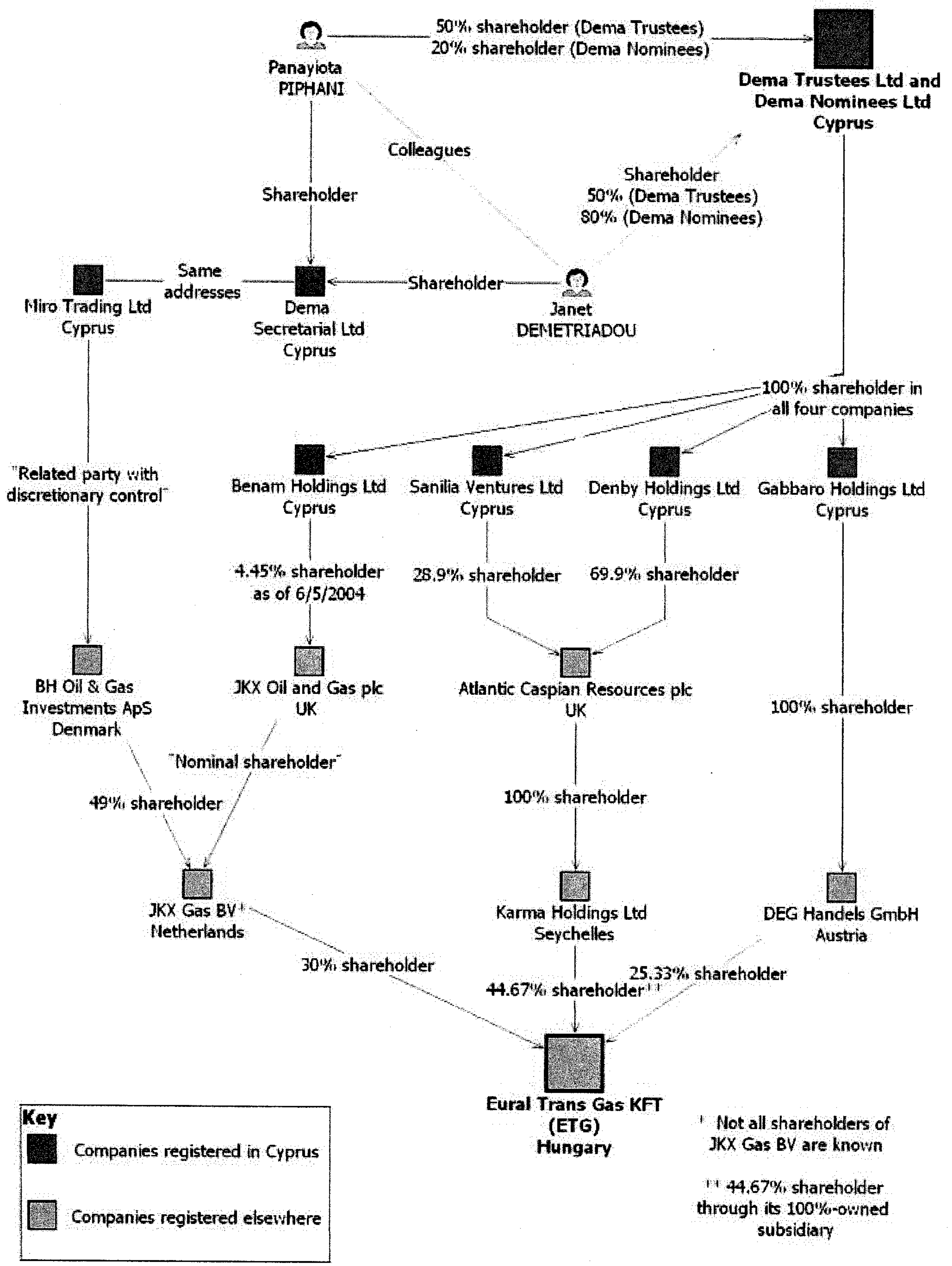
This part of the story starts with JKX Oil & Gas Plc, a publicly listed British company with operations in Russia, Ukraine, Georgia and other countries. In mid-2003 this British company was reportedly offered a shareholding in ETG by Naftohaz Ukrainy, Ukraine's state oil and gas company. The *Financial Times* reported that: 'Naftohaz said it hoped JKX's involvement would improve the image of Eural [Trans Gas].'[327] But it is not clear how Naftohaz could make this offer, given that the Ukrainian company did not own any shares in ETG at the time. 'What was strange was how Naftohaz spoke as if it controlled ETG,' said Tom Warner, the author of the article who has been covering the story of the intermediary companies for more than three years, to Global Witness.[328]

Around the same time, JKX Oil & Gas Plc announced an agreement in principle with a company called Benam Holdings to 'seek a participation in Eural Trans Gas.'[329] Benam Holdings owned just under 5% of JKX Oil & Gas at this time[330] and one of its directors was Robert Shetler-Jones of Denby Holdings.[331] Like Denby Holdings, Benam Holdings was jointly owned by Dema Nominees and Dema Trustees in Cyprus.[332]

Shetler-Jones has an association with JKX Oil & Gas: he told a Ukrainian journalist that he worked as a consultant for the British company and originally got involved in the Ukrainian gas industry through his friendship with one of its directors.[333] The company described its relationship with Shetler-Jones to Global Witness as 'confidential.'[334]

JKX Oil & Gas Plc did not become a direct shareholder in ETG but did acquire an indirect interest via a Dutch offshore company called JKX Gas BV, which was founded in September 2003 and later became the owner of 30% of ETG. A spokesperson for JKX Oil & Gas Plc told Global Wit-

Shareholders of Eural Trans Gas, April 2004



ness that the British company did own shares in JKX Gas BV but this 'was always a nominal investment'.[335] However, it appears that the British company, far from being a purely nominal investor, actually created the Dutch company and wholly owned it for the first three months of its existence, from September to December 2003.[336] Global Witness asked JKX Oil & Gas Plc to explain this apparent inconsistency, but received no reply.[337]

At the end of 2003 or soon afterwards, there was a change in the ownership of JKX Gas BV, although not all of the new owners have not been disclosed.[338] The directors also changed. One of the new directors was Howard Wilson, the associate of Robert Shetler-Jones and David Brown at Denby Holdings.

JKX Oil & Gas Plc remained a shareholder in JKX Gas BV until mid-2005.[339] Another shareholder in JKX Gas BV was a Danish company called BH Oil and Gas Investments ApS which, as of mid-2003, owned 49% of JKX Gas BV.[340] If neither the British company (with its 'nominal' shareholding) nor the Danish company were majority shareholders in JKX Gas BV at this point it would imply that there have been other shareholders in JKX Gas BV whose names have not come into the public domain. JKX Gas BV changed its name to BH Gas BV in 2005, with Howard Wilson remaining as one of the company's directors.[341]

So who owns BH Oil & Gas Investments ApS? Its records name three parties with 'discretionary control of the company', two men and one company.[342] One is a man who works for a Danish company that provides corporate services and is therefore likely to be a nominee director: he declined to respond to questions from Global Witness in March 2006. Global Witness has not been able to track down the second person, who seems to be of Greek origin.

The third controlling party of BH Oil & Gas Investments ApS is a Cypriot company, Miro Trading, whose address is 24 Ayias Varvaras Street, Nicosia.[343] This is also the address of Dema Secretarial Limited, a company directed by Dema Nominees' and Dema Trustees' owners.[344] Global Witness has not confirmed who owns Miro Trading. Global Witness has sought to obtain comment on matters related to Eural Trans Gas from three Cypriot accountants associated with the Dema companies, without success (see section: *All roads lead to Cyprus*).

There is no reason to believe that JKX Oil & Gas Plc has done anything wrong in relation to its involvement with ETG, but the British company has not answered an obvious

that it was linked to organised crime figures, allegations which were denied by ETG, but were of sufficient concern to be cited in a public forum by a senior US government official.[345] Against this background, what was the commercial rationale for this UK public company to allow its brand to be associated with ETG, even though the former had only a 'purely nominal' and indirect interest in the latter? Global Witness asked JKX Oil & Gas Plc to respond to this point. It replied: 'JKX Oil & Gas Plc has no comment.'[346]

The other striking aspect of the JKX story is that, like Atlantic Caspian Resources, JKX Gas BV was ultimately linked to the Dema companies in Cyprus (though the exact nature of this link, through Miro Trading, remains unclear). A similar link also exists for the third company that became a shareholder in ETG, DEG Handels.

C. DEG Handels

The third company that bought into ETG in April 2004 with a 25.33% shareholding was an Austrian firm, DEG Handels. Originally set up in 1990 as a company that rents machinery,[347] DEG Handels was bought by Gabbaro Holdings, another Cypriot company in early 2004, shortly before ETG announced its new owners.[348] Once again, Gabbaro Holdings is owned by Dema Trustees and Dema Nominees, each with a 50% stake.[349] This is the fourth indirect link between ETG and the Cypriot Dema companies.

DEG Handels also provides a curious link to RosUkrEnergo, the company that took over ETG's role as intermediary company in 2005: DEG Handels' registered address in Vienna is the same as CentraGas AG, which owns half of RosUkrEnergo (see section: *Links between RosUkrEnergo and Eural Trans Gas*).

All roads lead to Cyprus

So who are Dema Trustees and Dema Nominees? Cypriot company records name their owners as Janet Demetriadou and Panayiota Piphani.[350] Global Witness has established that Demetriadou and Piphani both work for a Nicosia-based accounting firm called Demetriades Shakos Piphanis,[351] which specialises in 'international tax planning' and sets up offshore companies in Cyprus in partnership with a firm that they direct called Dema Services, which has the same phone number as the accounting firm.[352] Global Witness faxed questions to Demetriadou and Piphani, asking them about their involvement in the Dema companies, but neither replied.[353] Few other details are available about the companies, other than that Dema Nominees was previ-